The Kernow Journal

KERNOW
ASSET MANAGEMENT

The Alternative UK Equity Market View

WHY INVEST IN THE UK?

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CONTENTS

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ASSET MANAGEMENT

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The UK market has an abundance of under-analysed companies with significant idiosyncratic components to their return profiles.

A note from THE EDITOR

Welcome to the third edition of the Kernow Journal.

In this edition, we address one of the questions we are most frequently asked - why invest in UK equities?

In *Why Invest in the UK*, we present an in-depth analysis and demonstrate that the UK offers a range of attractive investment opportunities. Overall, it is an undervalued market with a strong potential for growth. The UK market is liquid, under-researched and has one of the largest dispersion ratings in the developed world. This makes it an excellent destination for long-short strategies, adding credence to the Kernow investment proposition.

Global financial markets continue to grapple with challenges, including banking crises, higher inflation and geopolitical concerns. These issues have impacted investor confidence, leading many to wonder how best to navigate the current investment landscape. In our view, adhering to one's investment process with discipline is the best approach over the long term. Our investors tend to have diversified investments that are designed to thrive in any environment by design. They focus on finding the best providers of 'edge'.

In this regard, an awareness of historical market behaviour can be helpful, particularly if it aids in identifying patterns or trends relevant to the present. The key is to strike a balance and remain open to new information and insights as they emerge.

In other news, the extensive deployment of ChatGPT, a large-scale language model, has begun to take the world by storm. It is emerging as a ground-breaking innovation likely to disrupt multiple industries. These developments will significantly change the way that all people interact with technology. The full impact is still yet to unfold.

The emergence of big data, increased computing power and efficient algorithms has had an enormous impact on the economy over time, transforming an era of information scarcity into one of information ubiquity and competition for attention. In 'Kernow Contemplations', we reflect on the significance of this technological advancement.

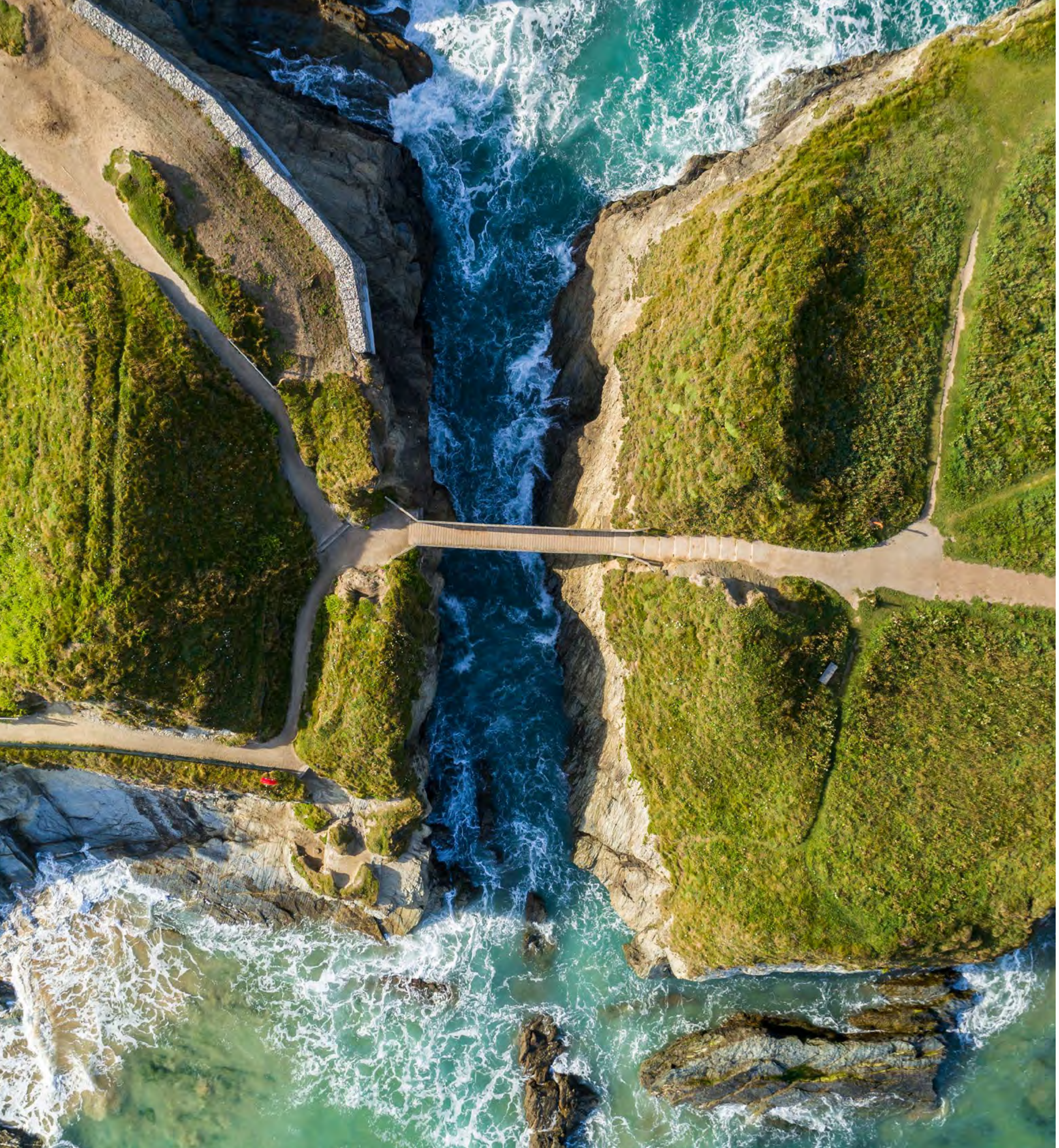
Lastly, we continue to celebrate exquisite visual representations in our 'Visual Elegance' segment. We showcase a visualisation that simply communicates multiple informational dimensions (geographical, quantitative, and qualitative).

Happy reading!

All the best,

Michael

Dr Michael Cook
Head Of Data And Analytics



Technology can help us absorb an overwhelming amount of information to form clear insights. This skill is crucial today, when informational complexity is relentlessly rising!

In tumultuous times, it is imperative to maintain clarity of thought and make sound decisions. It is essential not to be swayed by hype, groupthink or other biases that may compromise the investment process. A clear understanding of one's investment objectives is necessary to avoid being mired in 'analysis paralysis'

Large language models: is it all hype?

We have examined the excitement surrounding the recent release of large-scale language models, particularly ChatGPT. Although language models have been on our radar for some time, the remarkable usability and versatility of the latest version, Chat GPT, cannot be overstated.

When considering the impact of new technologies, we recall the 'Hype Cycle'. This graphical representation of the life cycle of new technologies and innovations was introduced by Gartner in 1995. It provides an intuitive framework for understanding the adoption and maturity of emerging technologies.

Using this framework, we can better comprehend the practical challenges and setbacks new technologies may face, as well as their potential benefits and future implications.

Kernow CONTEMPLATIONS

The cycle comprises five main phases:

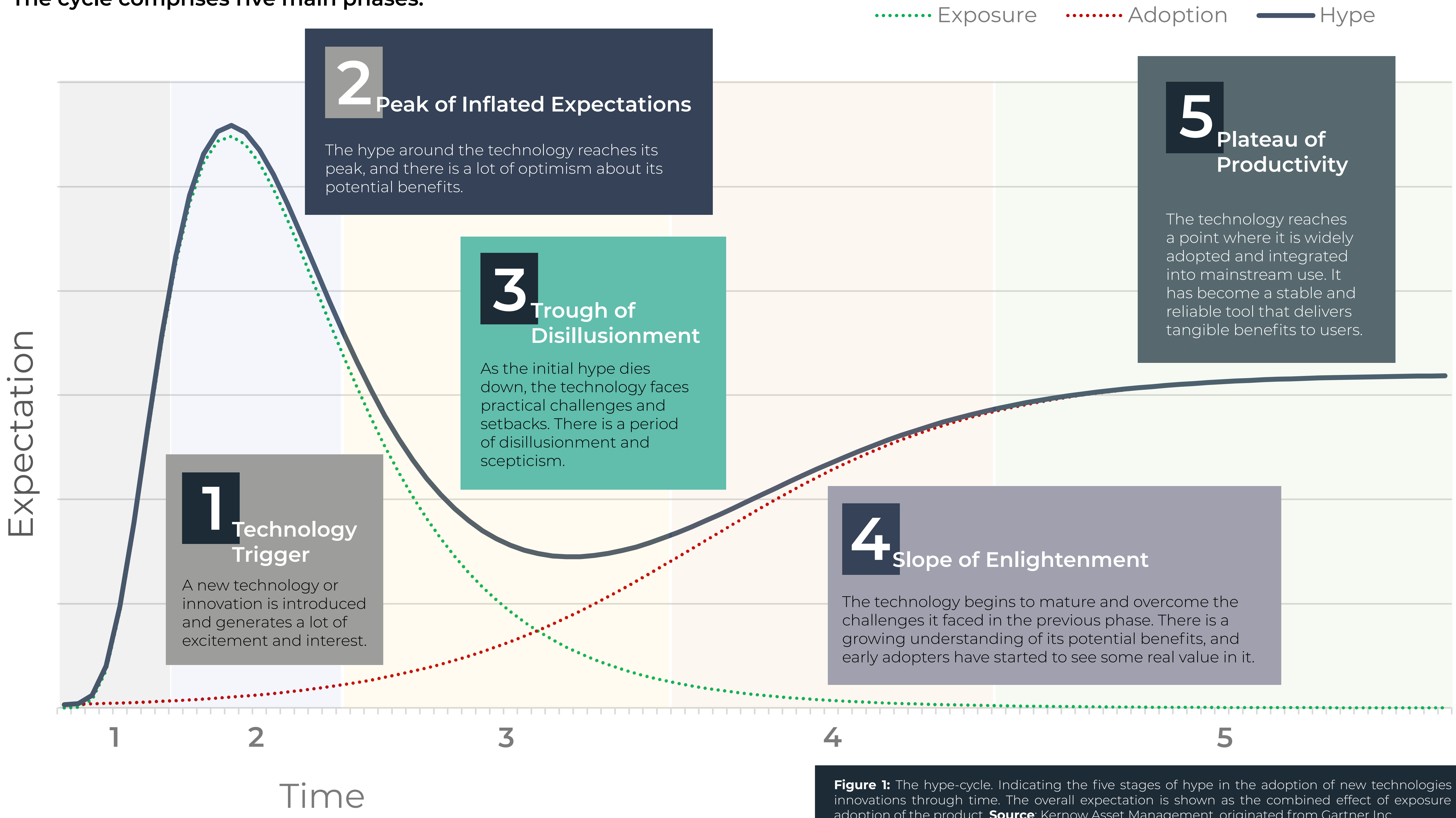


Figure 1: The hype-cycle. Indicating the five stages of hype in the adoption of new technologies and innovations through time. The overall expectation is shown as the combined effect of exposure and adoption of the product. **Source**: Kernow Asset Management, originated from Gartner Inc.

Kernow CONTEMPLATIONS

The Hype Cycle reflects the collective behavioural response of users to newly developed products. While the details of each innovation or technology launched are unique, it is noteworthy that their adoption patterns often follow a similar trajectory.

Although ChatGPT is currently in the first phase of the Hype Cycle, the speed at which it is being developed and adopted among broad user groups is remarkable. It attracted 100 million active monthly users in January 2023, just two months after its launch, making it the fastest-growing consumer application in history.

An indicator of the significance of a new technological advancement is government intervention, which is increasingly being employed to restrict the use of emerging AI tools. Discussions abound concerning the impact of Chat GPT on the job market and the sentient nature of AI, as well as its impact on the education sector and questions about authorship in academic work. We are witnessing a profound transformation in how humans interact with artificially intelligent systems.

How to manage the proliferation of data?

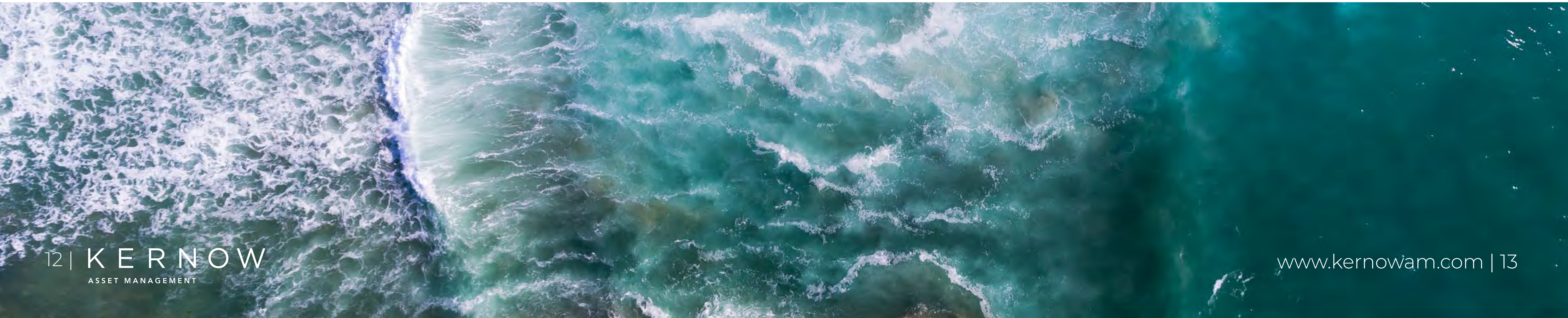
While the hype about specific esoteric use cases of large-language models is likely to die down, we expect that their use as a productivity tool will come to the forefront. These models can help collate, standardise and summarise a vast quantity of datasets into manageable insights, yielding substantial productivity gains - particularly in relation to investing.

Data was a relatively scarce commodity in earlier decades, with limited company disclosure and inconsistent reporting. Before digitisation, information was processed much more slowly than it can be today. This contrasts with modern times, where data is ubiquitous, and providers vie for attention. This topic has been considered since the 1970s and is attributed to the work of Herbert A. Simon, who coined the term ‘attention economy’. The attention economy refers to an economic system in which attention is a scarce and valuable resource and is traded as such. In the modern era, attention has become increasingly valuable: digital technology has enabled businesses to distribute more content than ever before, while individuals have more options as to how they spend their time.

With the rise of the internet, attention has become even more valuable. The vast amount of content available online, combined with the ability to target advertising to specific users, has created an environment in which attention can be monetised on an unprecedented scale. Social media platforms like Facebook and Twitter have further accelerated this trend by creating new channels for individuals and companies to capture and monetise attention.

In regard to investing, we are now barraged by information from increased company disclosures, presentations, outreach and a growing array of news sources, as well as numerous other sources of information, including analyst reports, blogs, podcasts, and social media. Managing this myriad of data is a challenge we enjoy. One of the increasingly essential disciplines in investing is determining the relevance, accuracy, and degree of bias among these information sources.

As contrarian investors, we reach conclusions based on our independent analysis and then compare this to the prevailing market conclusions. Where we find a significant mismatch, we stand by our conviction and invest accordingly.



Why Invest in the UK?

Introduction

We wanted to find out how the UK equity market compares to other international markets and whether it is a good time to invest. We completed a comprehensive analysis of the UK investment landscape, performing more than 20 independent tests to reach an objective view.

Our findings were overwhelmingly positive. The UK offers not only an attractive investment opportunity but a once-in-a-decade trade. Indeed, in May 2023, the IMF dramatically upgraded its economic growth forecast for the UK.

We also determined that, in order to invest wisely in the UK, allocator practitioners must look beyond the index due to the market's high dispersion.

10 UK Findings

Why invest in the UK?

1. Profits are increasing faster than in most other countries
2. An attractive destination for young, innovative and high-growth businesses
3. High-quality companies with low valuations offer higher potential returns
4. Top quartile dividend yields

To invest wisely in the UK, look beyond the index:

5. UK-listed companies are less widely understood
6. Exceptional idiosyncratic return percentage
7. Wide performance distribution attractive to long-short strategies
8. A highly-liquid market
9. Significant exposure to global revenue streams
10. Good governance and sustainability leadership

“Earnings growth drives stock prices, and the companies with the strongest earnings growth potential tend to outperform over time.”

Peter Lynch

Why invest in the UK?

1 Profits are increasing faster than in most other countries

Many companies listed on the UK stock market demonstrate strong growth potential. UK-listed companies have achieved high earnings growth (year-on-year) over the past 10 years and are projected to continue doing so.

Figure 2 shows the typical earnings growth of constituent companies in major indices across several countries. This indicates that UK-listed companies are positioned for significant earnings growth, surpassing most other geographies. Although it takes time for earnings growth to translate into share price returns, this data strongly indicates that UK-listed companies are growing and will continue to outperform their international counterparts in the near and medium term.

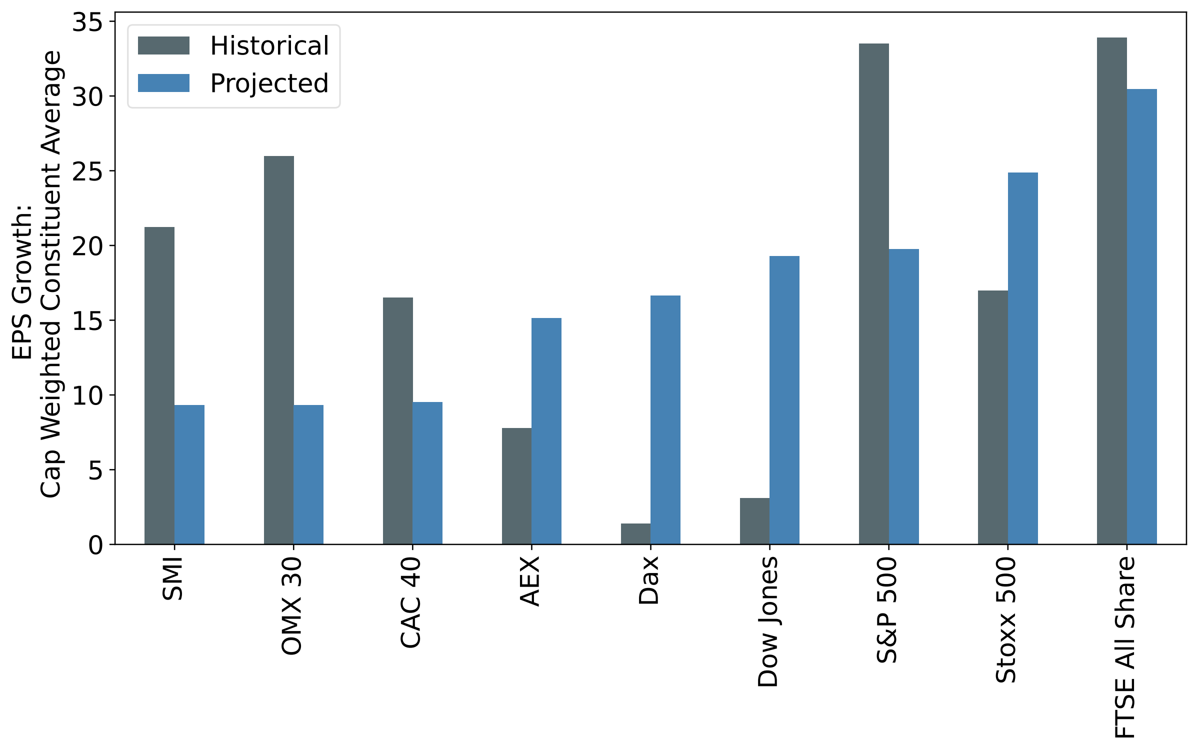


Figure 2: The year-on-year earnings growth, shown as the capitalisation-weighted average growth rate across constituents of each major index. Taking the historical data (current year/last year) and analyst projected (next year/current year). **Source:** Refinitiv, MSCI. As of: June-2023

Why Invest in the UK?

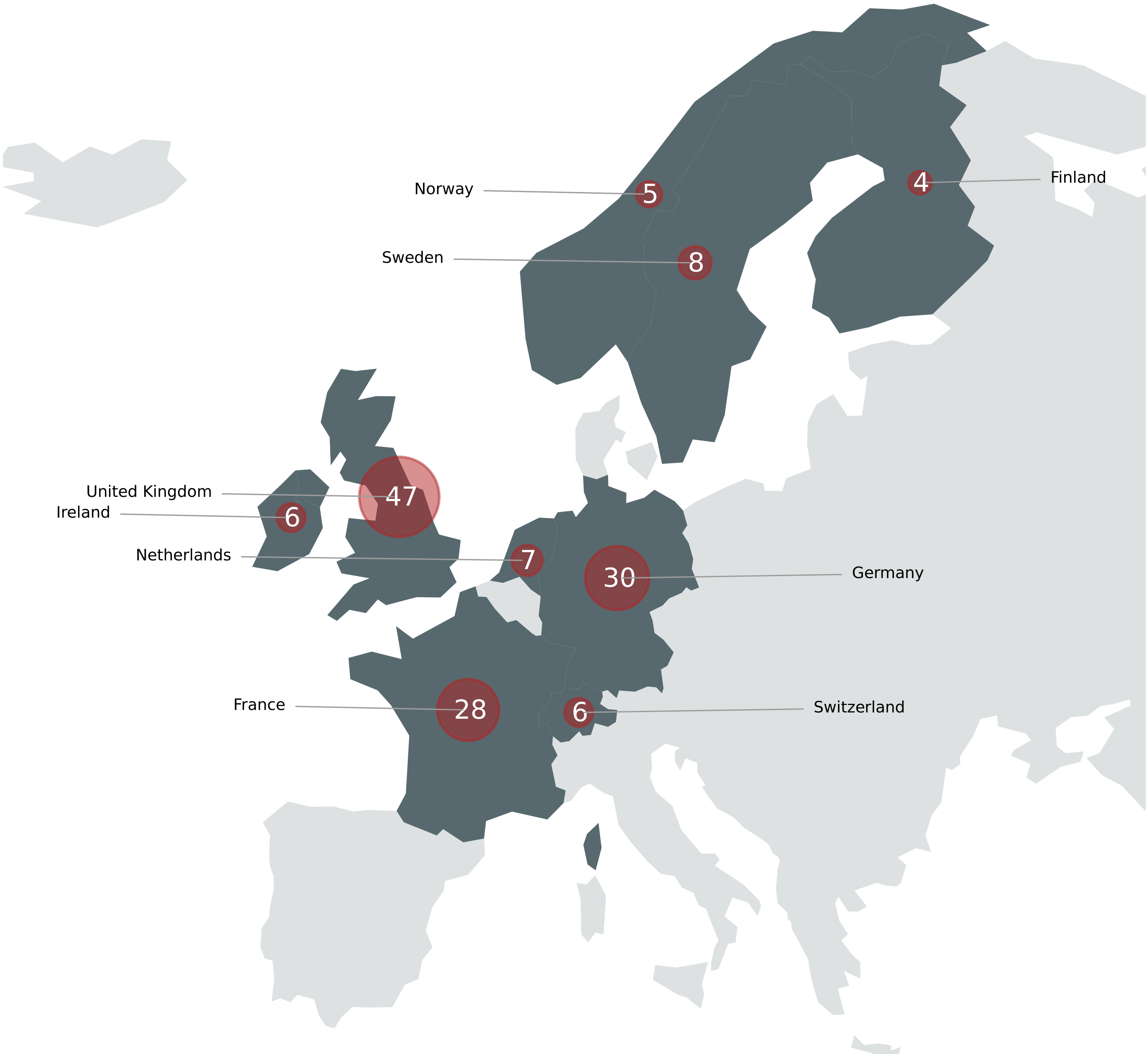


Figure 3: The number of 'unicorn' companies within European countries – defined as private companies with a valuation of $1 billion or more. **Source:** CB Insights, Statista Research. As of: August-2022

2 An attractive destination for young, innovative and high-growth businesses

The UK is known to be a fertile ground for innovation. The UK ranks fourth in the Global Innovation Index and boasts a world-class intellectual property regime that protects innovative ideas. England is home to four of the world's top ten universities: Oxford, Cambridge, University College London and Imperial College London. Its digital infrastructure network is also robust.

Innovation is key in the research and development (R&D) sector. Various academic studies suggest there is a close link between innovation and economic growth, which indicates that R&D has a direct impact on the economy.

The output of all this is that the UK had more unicorns (private companies with a valuation of US$1 billion or more) than any other European country.

Why Invest in the UK?

3 High-quality companies with low valuations offer higher potential returns

The quality of UK-listed companies, as measured by their return on equity, has broadly remained stable. As Figure 4 shows, despite Brexit, the return-on-equity of companies listed on the FTSE All-Share Index has increased slightly since 2016.

There has also been a significant decline in the valuations of these companies over the same period. We attribute this drop in valuations to the UK's unpopularity post-Brexit. This combination of good quality companies and their low valuation multiple generates a compelling return profile that does not require a re-rating. The net effect of this combination is that the prospective return on investment in UK-listed companies has increased. In other words, there is potential for higher yields on the same amount invested.

"Investors should look for quality companies that are trading at a discount to their intrinsic value. These are the types of investments that can provide both downside protection and upside potential over the long term."
Joel Greenblatt

That said, in an international context, this window of investment opportunity will not last forever. We expect that upward pressure on UK companies will cause a reversion to mean valuation levels.

Further evidence that UK-listed companies are undervalued arises from a comparison of the valuation characteristics of the FTSE All-Share Index to other global indices. We use the price-to-book (PB) ratio to compare the total capitalisation and total book-value of all index constituents. A low PB ratio suggests that the index is undervalued in comparison to its assets and presents an opportunity for investors to buy at a discounted price. Conversely, a high PB ratio indicates that the index is overvalued in comparison to its assets, such that investing in the index may be relatively expensive.

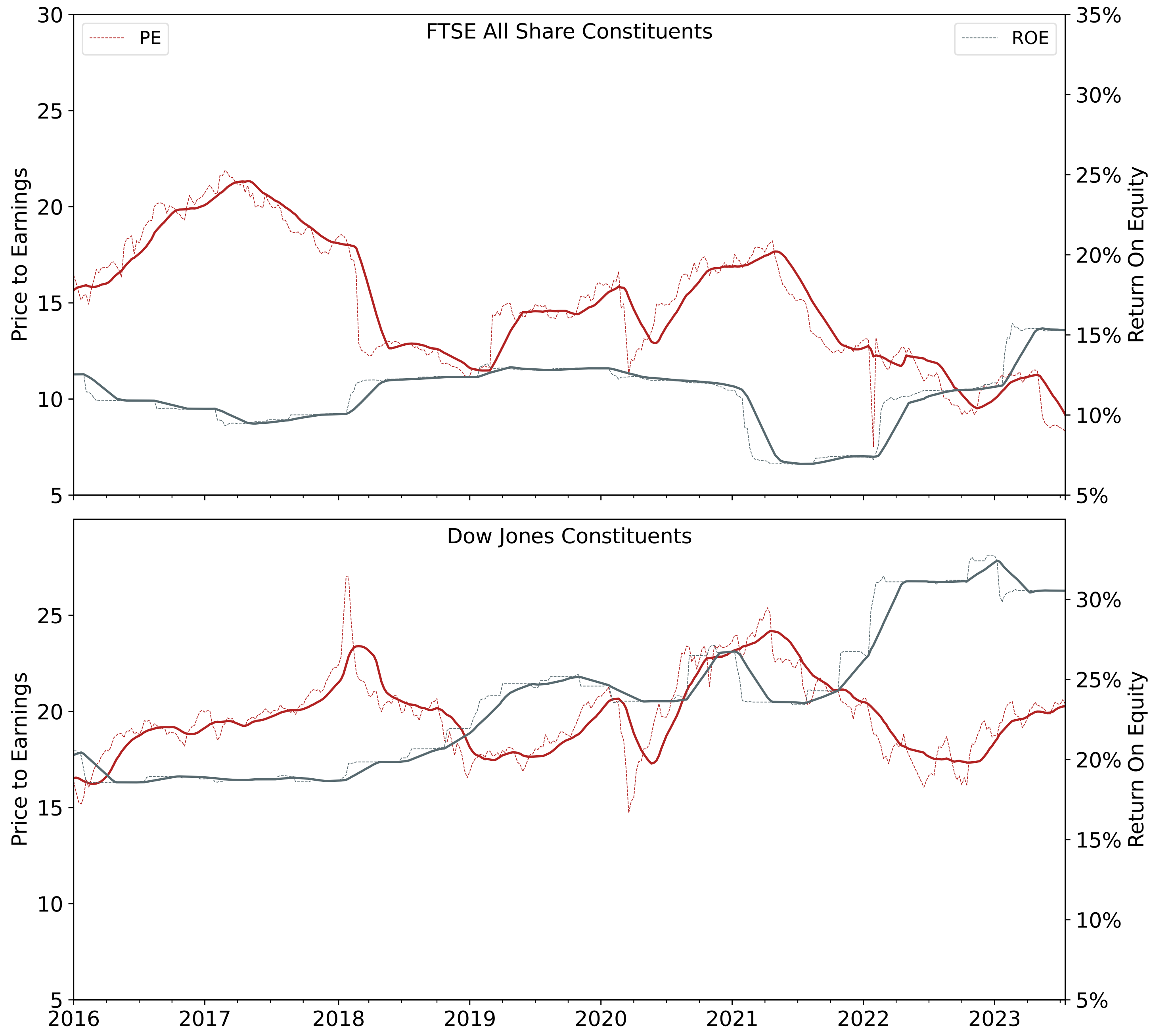


Figure 4: The recent timeseries evolution of value and quality for the FTSE All Share constituents (top panel) as compared to the Dow Jones constituents (bottom panel). For the UK we notice the price-to-earnings valuation measure steadily dropping since 2016 on the left-hand axis, as compared to the relatively stable return-on-equity quality measure which remains stable, on the right-hand axis. We contrast this with the US, which shows marginal increases in it's return-on-equity and no significant improvement in valuation prospects. **Source:** Refinitiv, LSE. As of: June-2023

Why Invest in the UK?

Figure 5 presents the PB ratio ranges of each index over the past decade and highlights the most recent levels as points for comparison. This indicates that the current valuation levels of the FTSE All-Share Index are lower than its historical valuation levels, situated in the bottom quartile. This implies that the UK market is well-positioned for potential gains as most markets experience a return to comparable valuation levels over time, and indeed often overshoot those levels. The FTSE All-Share Index valuation levels are lower than those of other indices, which presents a compelling buying opportunity for UK-listed equities overall.

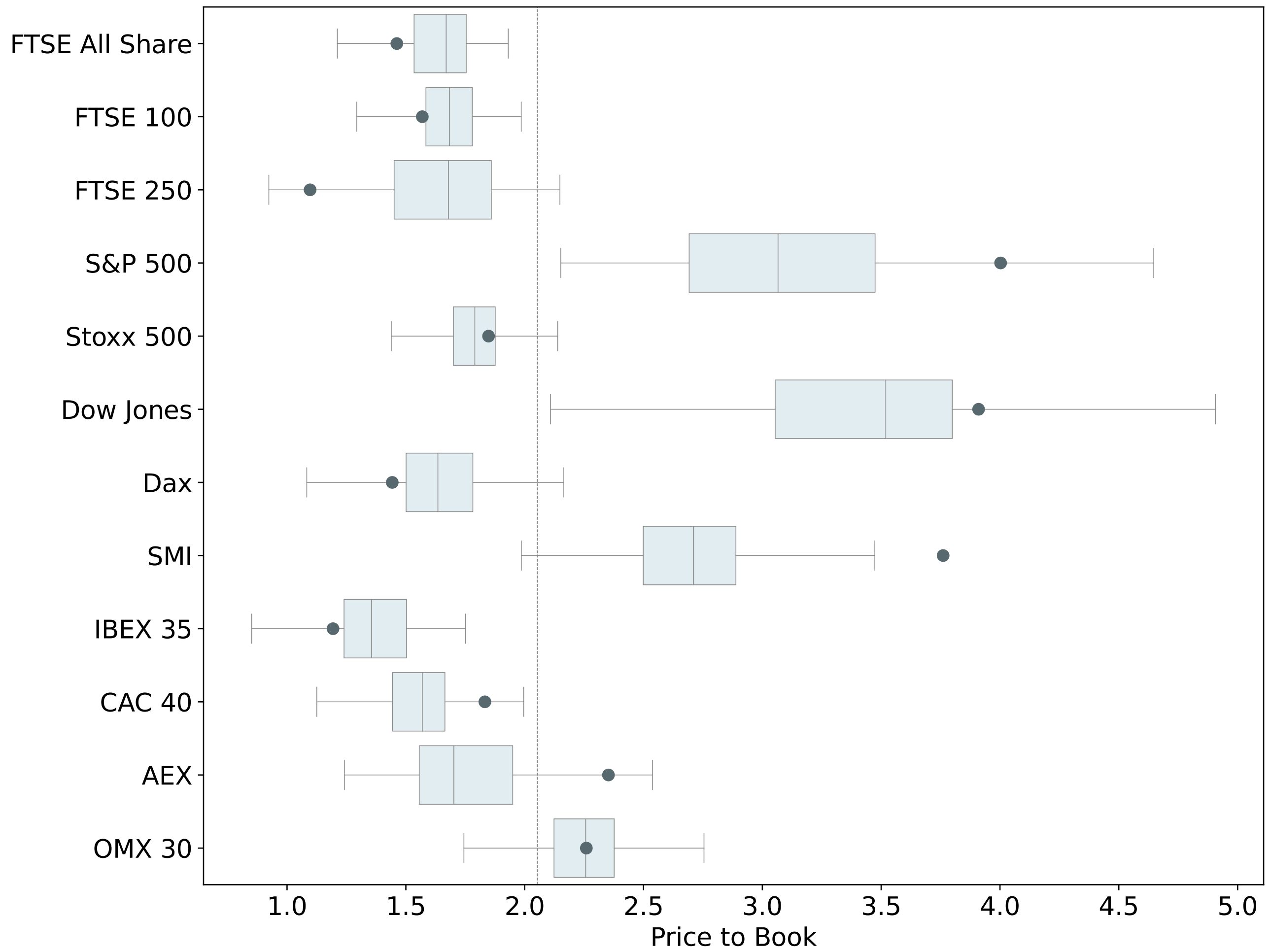


Figure 5: A box-plot showing the price-to-book valuation levels for major European and Global indices. The boxes represent the median and interquartile range, and the whiskers show the full range of the price-to-book levels, calculated daily for the indices since July 2013. The points showing the latest data points (June-2023). Finally, the vertical line highlights the average across the various indices.
Source: Refinitiv, LSE. As of: June-2023

"Buying an undervalued company is like buying a bargain-priced house that requires renovation: If you have patience and a realistic plan, the rewards can be substantial."

Seth Klarman

Why Invest in the UK?

4 Top quartile dividend yields

Not only do UK-listed companies offer relatively high potential yields, they also are statistically likely to share their yields with investors in the form of dividends.

2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
IBEX 35 4.8	IBEX 35 4.7	IBEX 35 5.5	IBEX 35 4.6	IBEX 35 3.9	IBEX 35 4.2	FTSE 100 4.6	IBEX 35 4.9	FTSE 100 3.3	FTSE 100 3.8	IBEX 35 3.9
FTSE 100 4.0	FTSE 100 3.9	FTSE 100 4.1	FTSE 100 4.3	FTSE 100 3.9	FTSE 100 4.1	IBEX 35 4.4	FTSE 100 4.4	IBEX 35 3.2	IBEX 35 3.7	FTSE 100 3.8
FTSE All Share 3.8	FTSE All Share 3.7	FTSE All Share 3.9	OMX 30 4.2	FTSE All Share 3.7	OMX 30 4.0	FTSE All Share 4.4	FTSE All Share 4.2	FTSE All Share 3.1	FTSE All Share 3.7	FTSE All Share 3.8
OMX 30 3.7	OMX 30 3.7	OMX 30 3.8	FTSE All Share 4.0	OMX 30 3.6	FTSE All Share 3.9	OMX 30 4.0	AEX 3.3	SMI 2.7	OMX 30 3.4	FTSE 250 3.6
Stoxx 500 3.4	Stoxx 500 3.3	Stoxx 500 3.4	CAC 40 3.8	AEX 3.4	AEX 3.5	Stoxx 500 3.6	Stoxx 500 3.3	Stoxx 500 2.5	Dax 3.3	Dax 3.4
CAC 40 3.4	CAC 40 3.3	CAC 40 3.1	AEX 3.8	SMI 3.3	Stoxx 500 3.4	AEX 3.5	Dax 3.2	OMX 30 2.4	Stoxx 500 3.2	Stoxx 500 3.3
Dax 3.1	SMI 3.0	SMI 3.1	Stoxx 500 3.6	Stoxx 500 3.3	SMI 3.4	CAC 40 3.3	SMI 3.2	Dax 2.3	FTSE 250 3.1	OMX 30 3.3
SMI 2.9	FTSE 250 2.8	AEX 2.9	SMI 3.5	CAC 40 3.2	CAC 40 3.2	SMI 3.3	FTSE 250 3.1	AEX 2.3	CAC 40 3.0	SMI 3.1
AEX 2.8	AEX 2.8	FTSE 250 2.8	Dax 3.0	FTSE 250 2.8	Dax 3.0	FTSE 250 3.3	OMX 30 3.0	CAC 40 2.2	SMI 2.9	CAC 40 3.1
FTSE 250 2.7	Dax 2.8	Dax 2.7	FTSE 250 3.0	Dax 2.7	FTSE 250 2.8	Dax 3.2	CAC 40 2.9	FTSE 250 2.1	AEX 2.8	AEX 2.6
Dow Jones 2.4	S&P 500 2.3	Dow Jones 2.5	Dow Jones 2.7	Dow Jones 2.4	S&P 500 2.4	S&P 500 2.4	S&P 500 2.4	Dow Jones 1.9	Dow Jones 2.3	Dow Jones 2.4
S&P 500 2.4	Dow Jones 2.3	S&P 500 2.4	S&P 500 2.6	S&P 500 2.4	Dow Jones 2.3	Dow Jones 2.4	Dow Jones 2.4	S&P 500 1.8	S&P 500 2.0	S&P 500 2.1

Figure 6: A quilt chart showing the dividend yields for major domestic indices annually. The UK market (FTSE All Share) is highlighted in blue. Vertical ordering represents the relative ranking of country indices, and colours highlight the particular country index. **Source:** Refinitiv. As of: June-2023

Although dividend yields are not our primary concern as investors, they are important for several reasons. They indicate the income potential of an index, which will be of interest to investors who seek a stable income stream. A high dividend yield also indicates that companies within the index have good financial performance and are generating healthy profits. Dividend-paying companies tend to be in a better financial position with more stable cash flows than companies that do not pay dividends. This can help them to weather challenging economic conditions. Historically, companies that consistently pay dividends have exhibited greater resilience during periods of market stress or economic downturn.

"Dividends are the investor's equivalent of taking a spoonful of castor oil each morning: they may not like the taste, but they are probably good for them."
Milton Friedman

Figure 6 ranks the annual dividend yields of the major European indices over the past decade. Companies listed on the FTSE All-Share Index generally offer higher dividend pay-outs than companies listed on most other European indices.

To invest wisely in the UK, look beyond the index

It is not enough to simply conclude that the UK is a compelling investment environment. The method of investment is a crucial consideration. To put it plainly, buying the index is not sufficient. How an investor chooses to access the UK has important ramifications for their potential risk and returns.

5 UK-listed companies are less widely understood

If stocks are undervalued relative to their true worth, this creates a potential investment opportunity. UK-listed companies are less widely understood than their counterparts in other leading markets. There is a clear opportunity for diligent research to take advantage of this disparity to provide an investment edge.

As a proxy we consider analyst coverage – namely, the number of equity research analysts who actively follow a given company's financial performance and provide their insights and recommendations to clients. The level of analyst coverage can provide valuable information about a company's investment prospects. Higher levels of coverage can indicate that a company is more likely to be significant in size, operations, or market share. Conversely, companies with lower levels of analyst coverage receive less attention and may have greater room for growth and development than their more established peers. Such companies may have innovative products or services that are not yet fully appreciated by the market. This also works for over-appreciated companies that are trading on fads.

Figure 7 presents the levels of analyst coverage for companies in eleven leading market indices. There are seven tranches of analyst coverage shown for each index, with the lowest tranche (companies with less than five analysts) shown in dark green and the highest tranche (companies with over 30 analysts) shown in dark red.

Why Invest in the UK?

This shows that companies listed in the FTSE All-Share Index have low levels of analyst coverage, with approximately 60% of constituents having coverage of fewer than 10 analysts. The UK has a greater proportion of companies with low analyst coverage than any other leading market index. By contrast, for example, over 60% of companies listed on the Dow Jones Index are each covered by over 25 analysts. The UK presents a compelling opportunity for diligent investment approaches that conduct their own research into lesser-analysed companies.

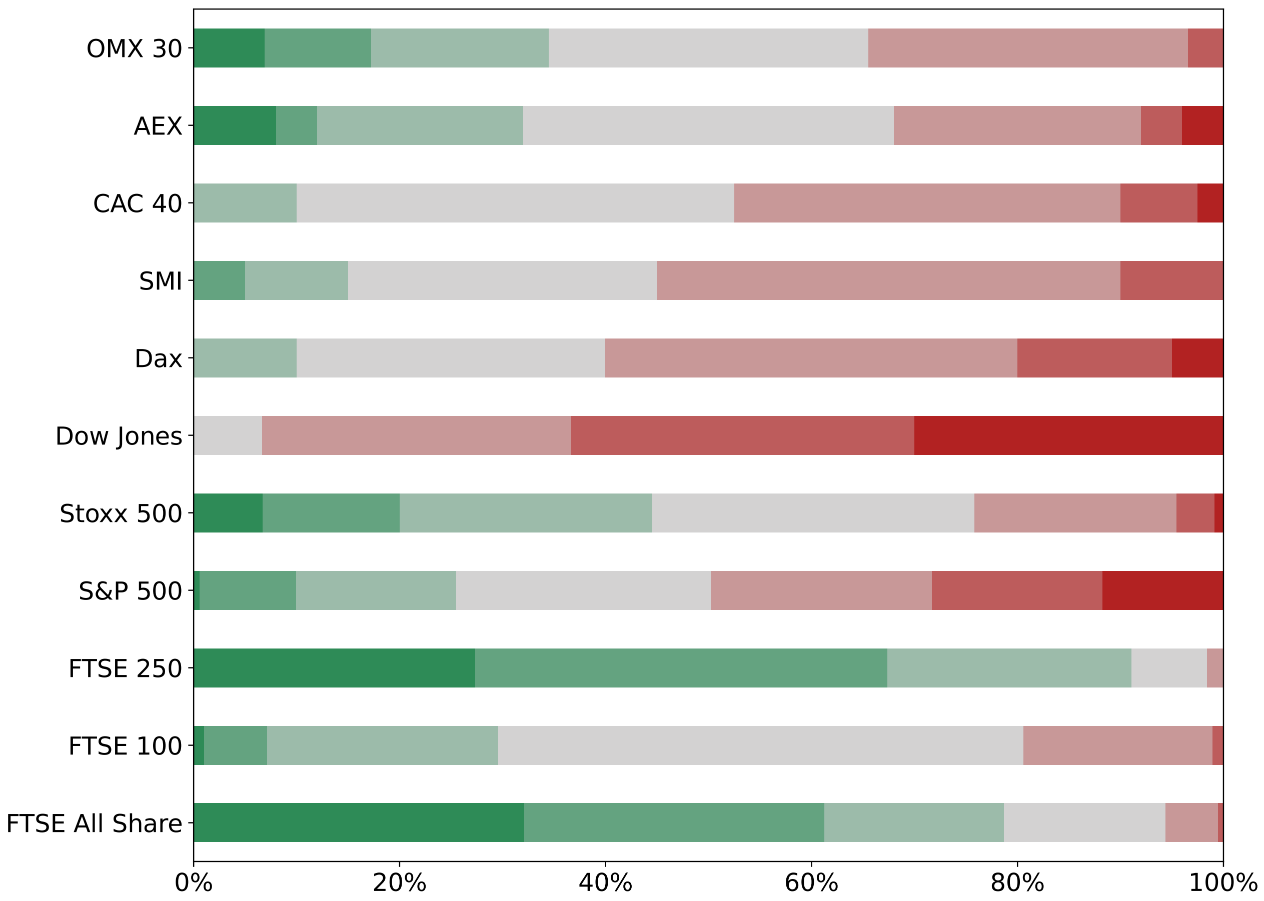


Figure 7: The fraction of index constituents of major country indices, by their level of analyst coverage. Using the following seven partitions of increasing coverage; under-5, 5-10, 10-15, 15-20, 20-25, 25-30 and over-30. **Source:** Refinitiv. As of: June-2023

Why Invest in the UK?

6 Exceptional idiosyncratic return percentage

Share price movements in the UK are more responsive to company performance than high-level macroeconomics or overall country performance.

UK-listed companies have highly idiosyncratic returns as compared to their international counterparts. More idiosyncratic sector-level volatility signifies a robust market in which share price movements are primarily influenced by sector-specific factors rather than broader market trends.

Figure 8 compares the volatility of idiosyncratic returns across sectors, annualised over the past decade, both within the UK and globally. To obtain the sector-specific idiosyncratic returns, we extract GICS Sector indices within the UK and global universes and subtract the headline index.

UK-listed companies exhibit more sector-level idiosyncrasy across all sectors than the global universe. Within the UK, companies in the Materials sector exhibit the most idiosyncratic returns, followed by those in the Energy and Information Technology sectors.

Further evidence is provided by investigating the correlation between security returns and their respective sectors and markets. Figure 9 considers the average explained variance of 11 leading global market indices, utilising a Capital Asset Pricing Model regression analysis as against the sector, market and the combination of both market and sector. This assessment approximates the extent to which each index moves in an idiosyncratic manner.

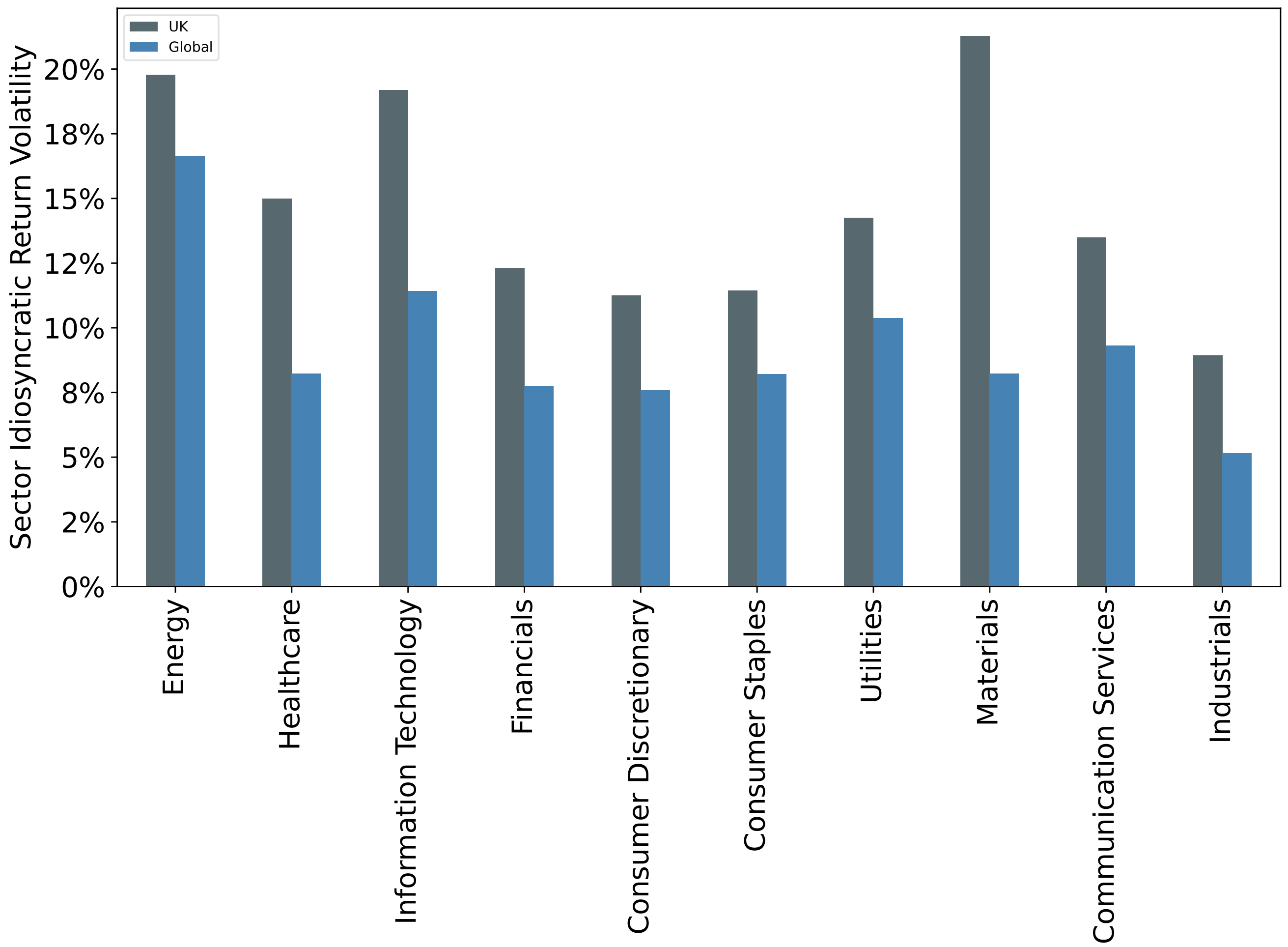


Figure 8: The idiosyncratic sector volatility, comparing MSCI UK and MSCI Global constituents. Idiosyncratic volatility is defined as the standard deviation of abnormal returns of the sector relative to the parent market. Calculated on an annualised basis since July 2013. **Source:** Refinitiv, MSCI. As of: June-2023

Why Invest in the UK?

The FTSE All-Share Index is the most idiosyncratic index, with relatively low levels of explained variance attributable to the market and sector. This finding is particularly important because returns with higher degrees of idiosyncrasy indicate an attractive environment for thoughtful investors who capture returns through fundamental bottom-up analysis, such as Kernow.

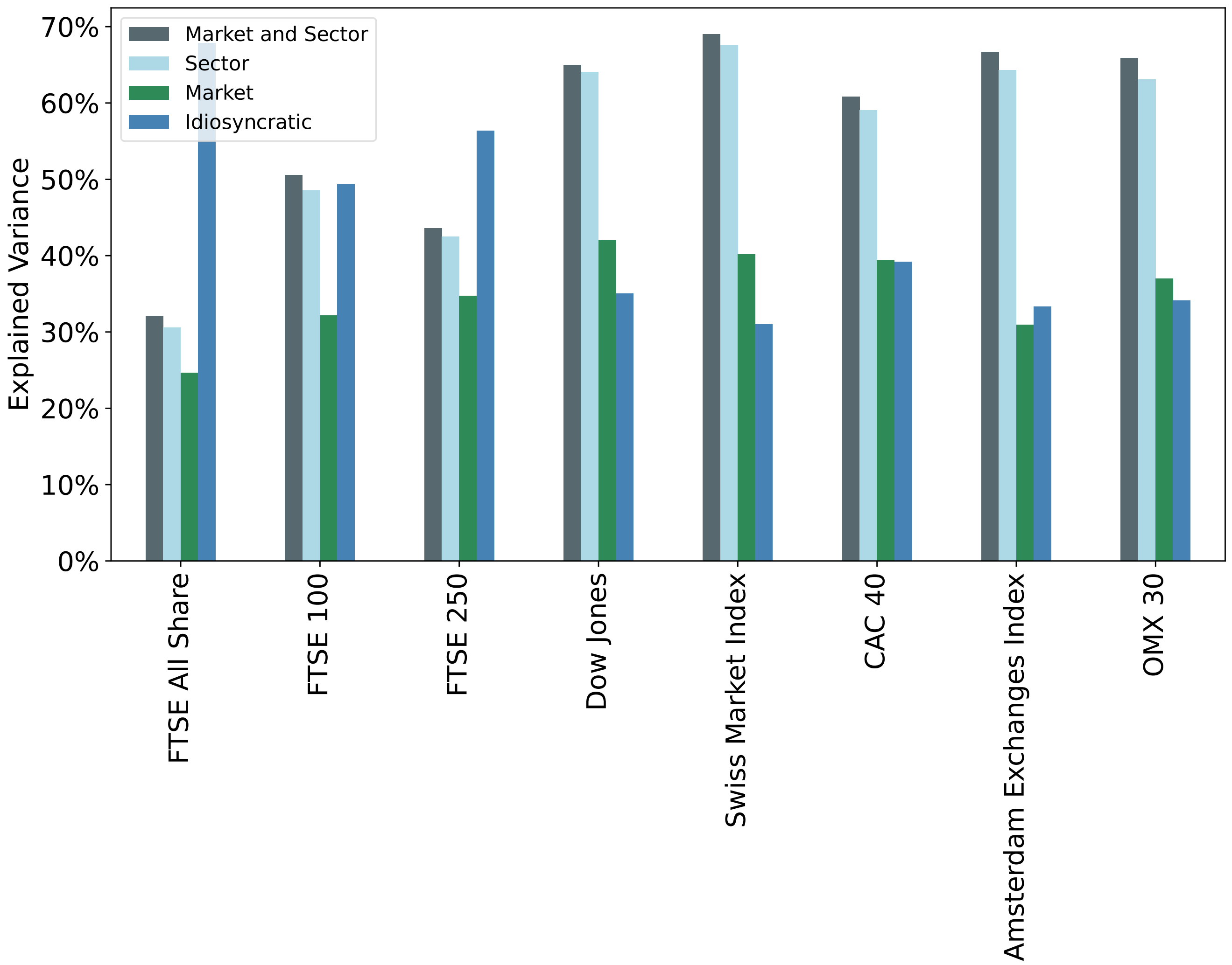
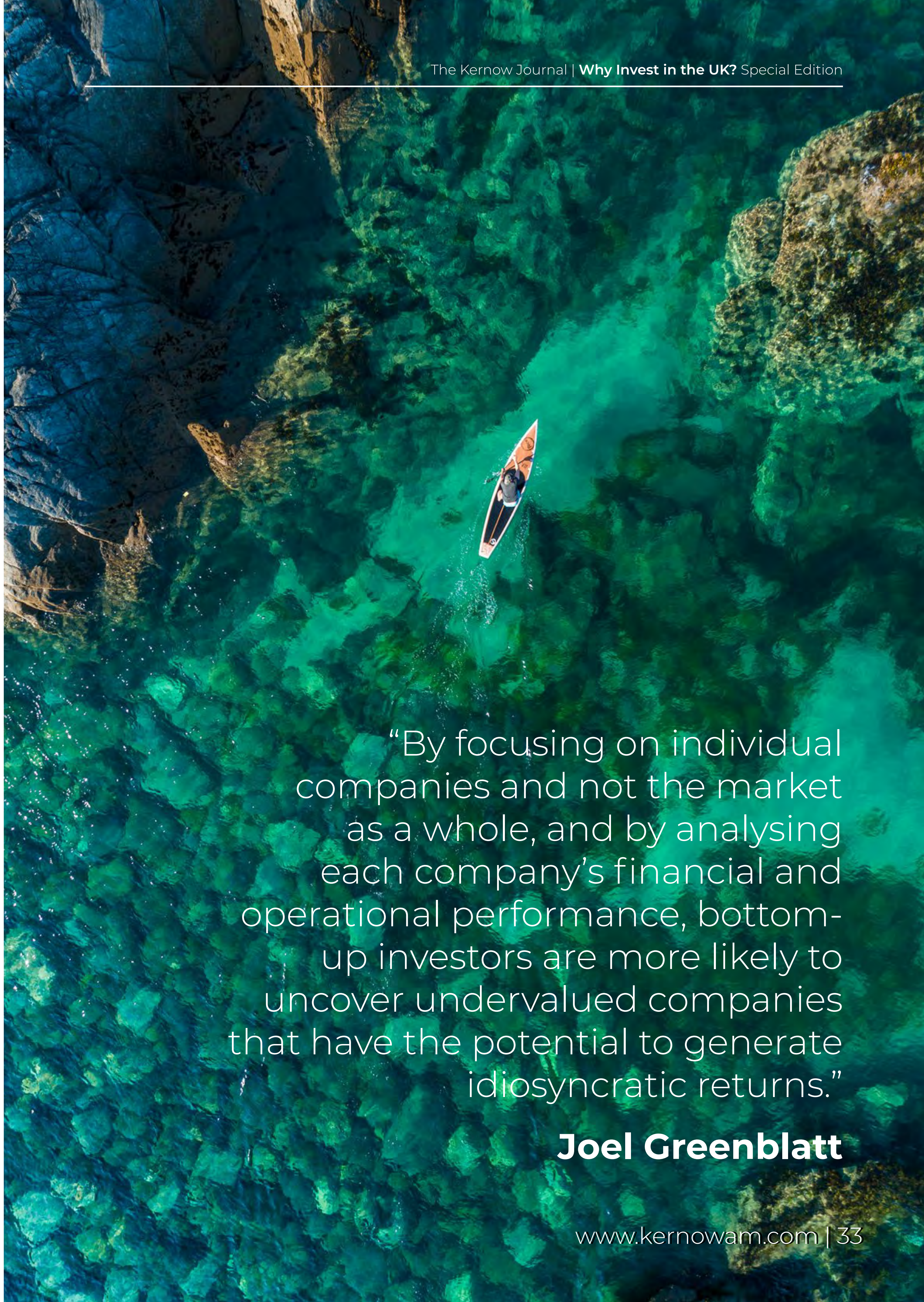


Figure 9: The average explained variance, as calculated using the adjusted R-squared, for constituents of major European and Global indices. Calculated using Market, Sector and Market-plus-Sector least-square regressions using daily total returns data from July-2013. **Source:** Refinitiv, MSCI. As of: June-2023



"By focusing on individual companies and not the market as a whole, and by analysing each company's financial and operational performance, bottom-up investors are more likely to uncover undervalued companies that have the potential to generate idiosyncratic returns."

Joel Greenblatt

Why Invest in the UK?

7 Wide performance distribution attractive to long-short strategies

To investigate the cross-sectional spread in fortunes of companies within different markets, we assess the distribution of returns across the constituent companies of several leading global market indices. Cross-sectional return dispersion is, in essence, a snapshot of how constituent companies perform relative to one another.

Higher levels of dispersion suggest a greater range of returns across constituent companies, which may be due to differences in underlying fundamentals, growth prospects, risk exposures or other factors that drive returns. High levels of dispersion indicate greater opportunities for skilled stock selectors to identify under or overvalued stocks and to design portfolios that outperform the index. By contrast, low levels of dispersion suggest that the differences in returns are relatively small, which may make it more difficult for the same effort for active managers to generate alpha by identifying mispricing.

"The dispersion of returns among individual securities, industry sectors, and asset classes creates opportunities for well-diversified portfolios to add value."
David Swensen

Figure 10 compares the average cross-sectional return dispersion among constituents of several global market indices over the past 12-months. The FTSE All-Share Index has the highest level of return dispersion, suggesting that it offers the broadest range of opportunities for out- and under-performance.

Next, we turn to another measurement: investment quality. Although precise metrics may vary, a company is considered to have strong investment quality characteristics if it is safe, profitable, growing and efficiently governed. We use return on equity (ROE) as a proxy for investment quality. Investors are willing to pay a premium for companies that exhibit these characteristics to a greater degree.

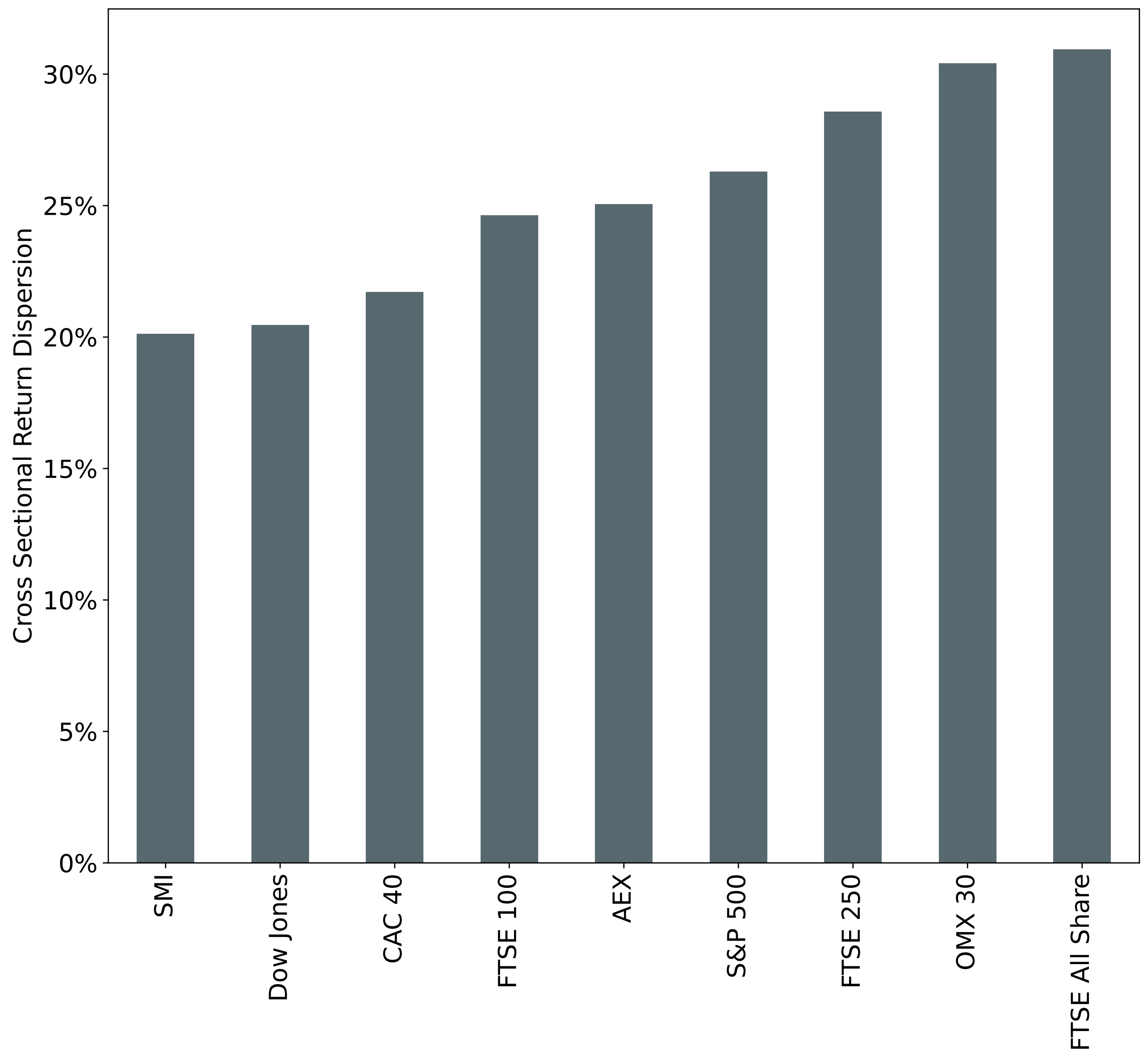


Figure 10: The average dispersion of daily returns, computed across all active constituents of major European and Global indices. Computed as the annualized standard deviation of daily returns, and then time-averaged from July-2013. **Source:** Refinitiv, MSCI. As of: June-2023

Why Invest in the UK?

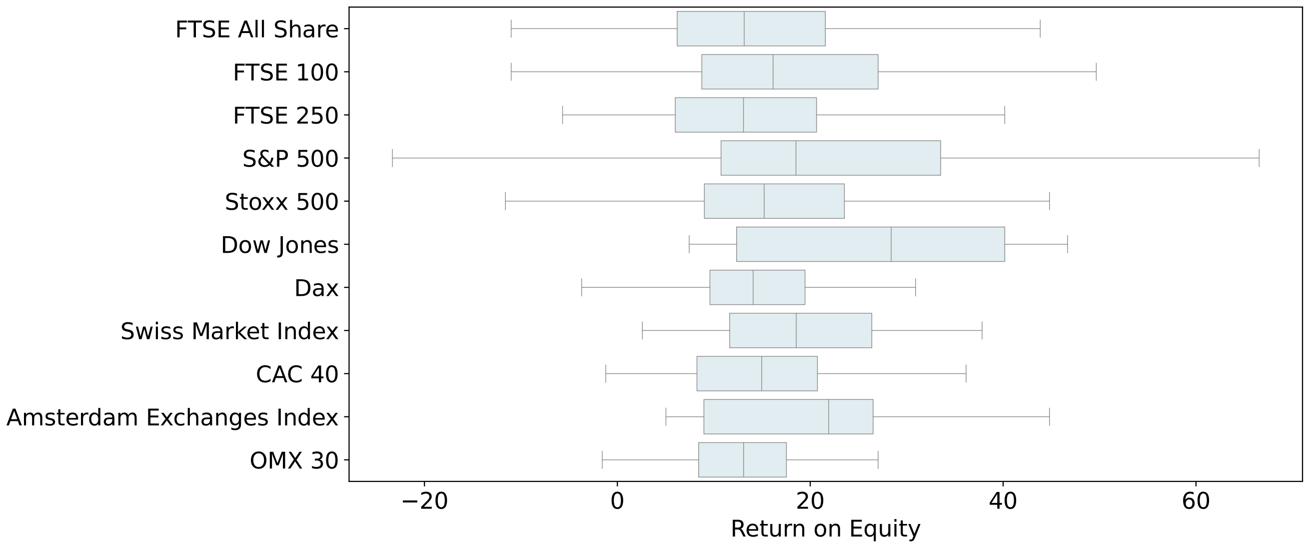


Figure 11: A box-plot showing the distribution of the Return-on-Equity (ROE) quality metric, computed across active constituents of major European and Global indices since July-2013. The boxes represent the median and interquartile range of the index-level ROE, and the whiskers show the full range. **Source:** Refinitiv. As of: June-2023

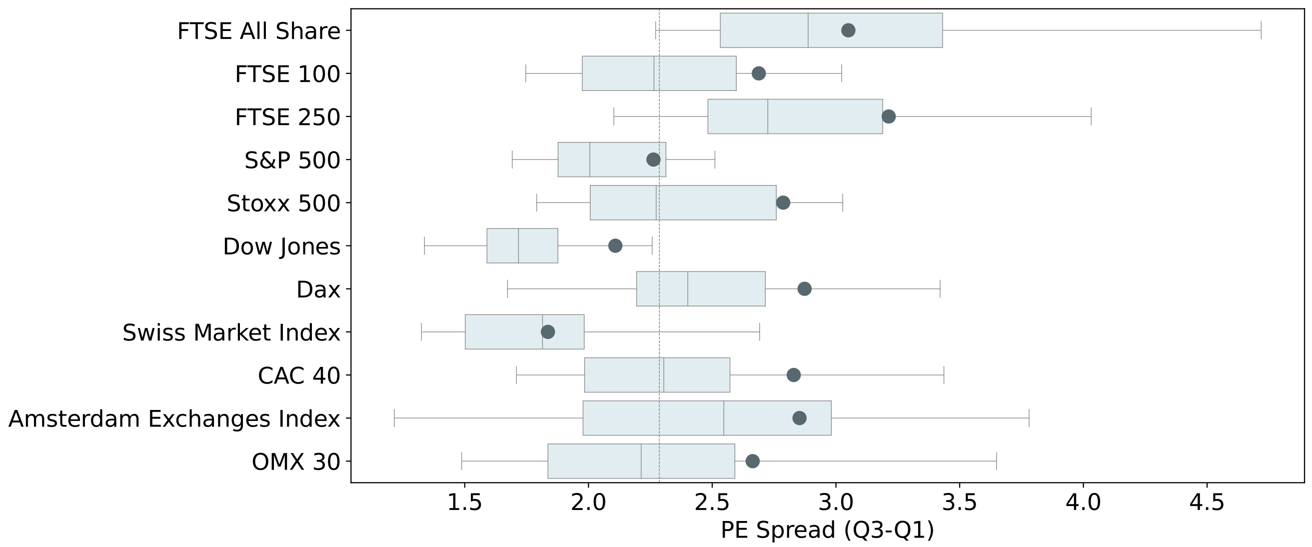
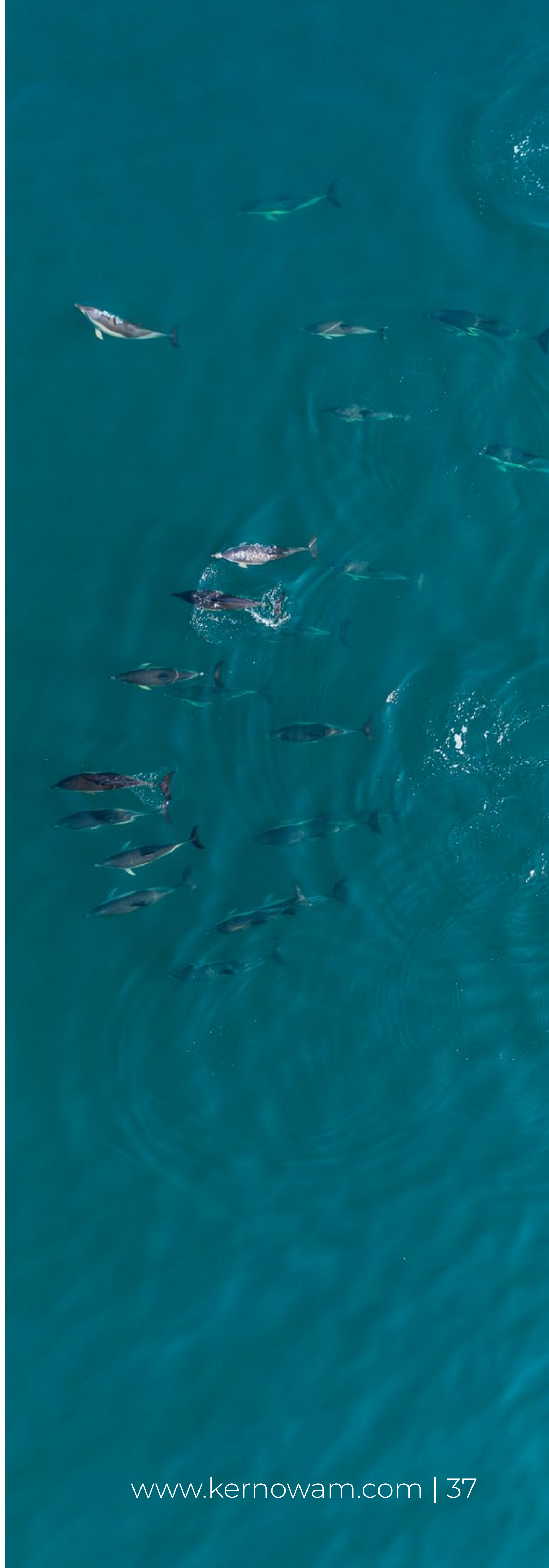


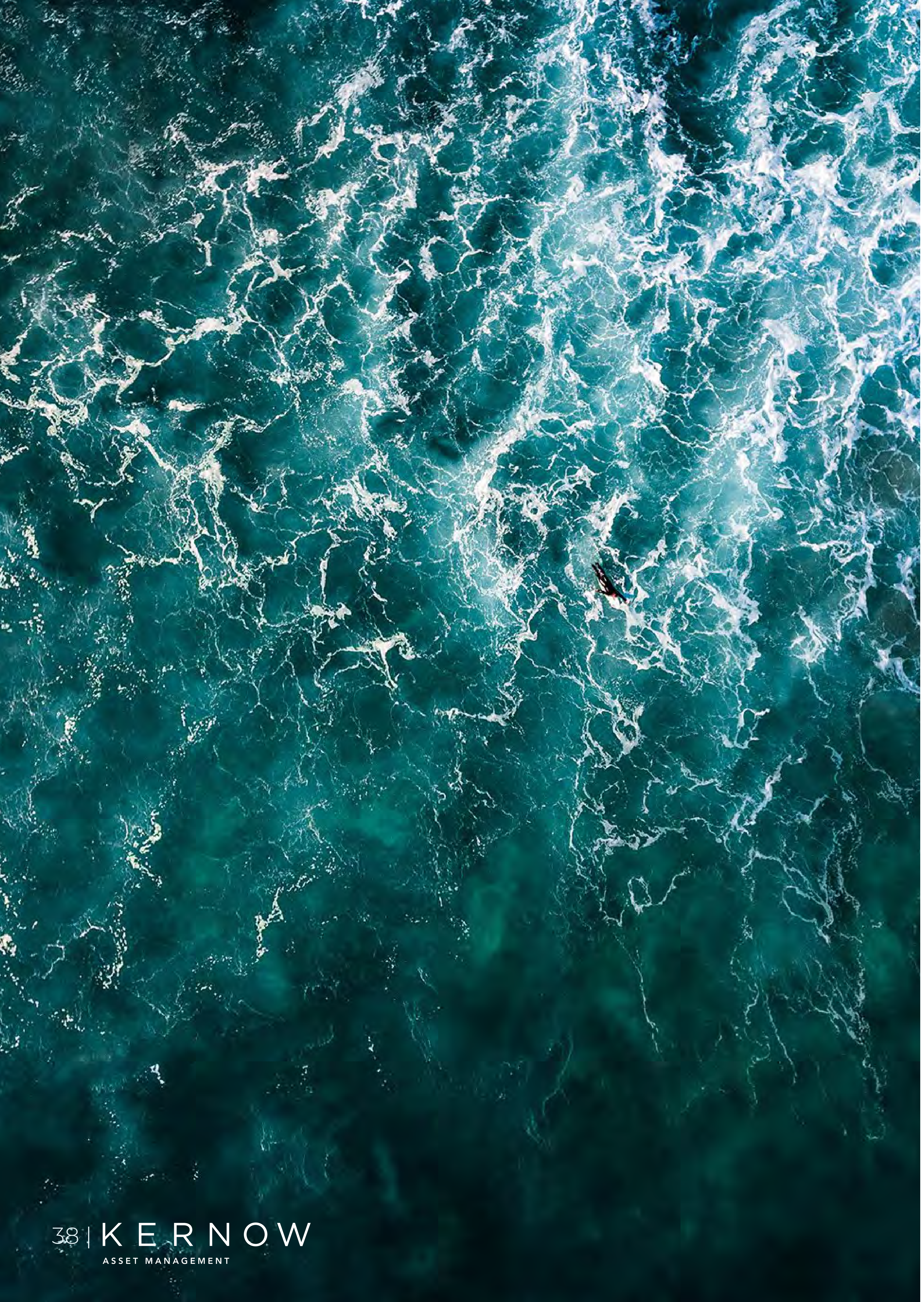
Figure 12: A box-plot showing the distribution of the distribution of the Price-to-Earnings (PE) spread, as defined by the ratio of the upper-quartile to lower-quartile PE level across constituents of major Global and European indices since July 2013. The boxes represent the median and interquartile range of daily spreads, and the whiskers show the full range. **Source:** Refinitiv. As of: June-2023

Figure 11 compares the distribution of ROE across the constituents over the past decade, for the same leading market indices as shown in Figure 10. The FTSE All-Share Index has a relatively broad spread in constituent ROE. A broad spread of ROE is a strong indicator of the future efficacy of a 'quality minus junk' investment strategy, i.e., one which involves investment in high-quality companies while shorting low-quality ones.

Valuation spreads are cross-sectional differences in valuations that are indicative of relative value opportunities within a group of securities. The breadth of the valuation spread translates to the distance between undervalued and overvalued companies. A higher valuation spread indicates a wider gulf between the two, which offers outsize opportunities for long-short investment strategies.

Figure 12 compares the price-to-earnings spreads across the leading global market indices. The FTSE All-Share Index has the highest spread, with current levels in-line with historical performance. The gap between a highly prized company and a barge pole company is remarkable. The PE ratios in the UK can move a long way and still be 'normal', offering greater potential returns. This finding is great for Kernow, who trades a fundamentally driven, mean reverting strategy. Given the dearth of competitors, we can expect to sustain a decent edge for a long time.





8 A highly liquid market

Market depth is important because it allows investors to adjust their portfolios with ease and without incurring significant costs or market disruptions. A highly liquid market has greater competition boosting price discovery. This also yields lower borrowing costs, which means that companies can raise capital more easily.

The UK equity market is highly liquid, which makes it cost-effective for investors to trade and allows investors to express their convictions efficiently.

Figure 13 compares the average bid-ask spread for the most-capitalised securities within each of the leading global market indices. This is a good measure for liquidity. Figure 13 indicates that the FTSE All-Share Index has the third-highest levels of liquidity, closely following the Dow Jones and S&P 500 indices.

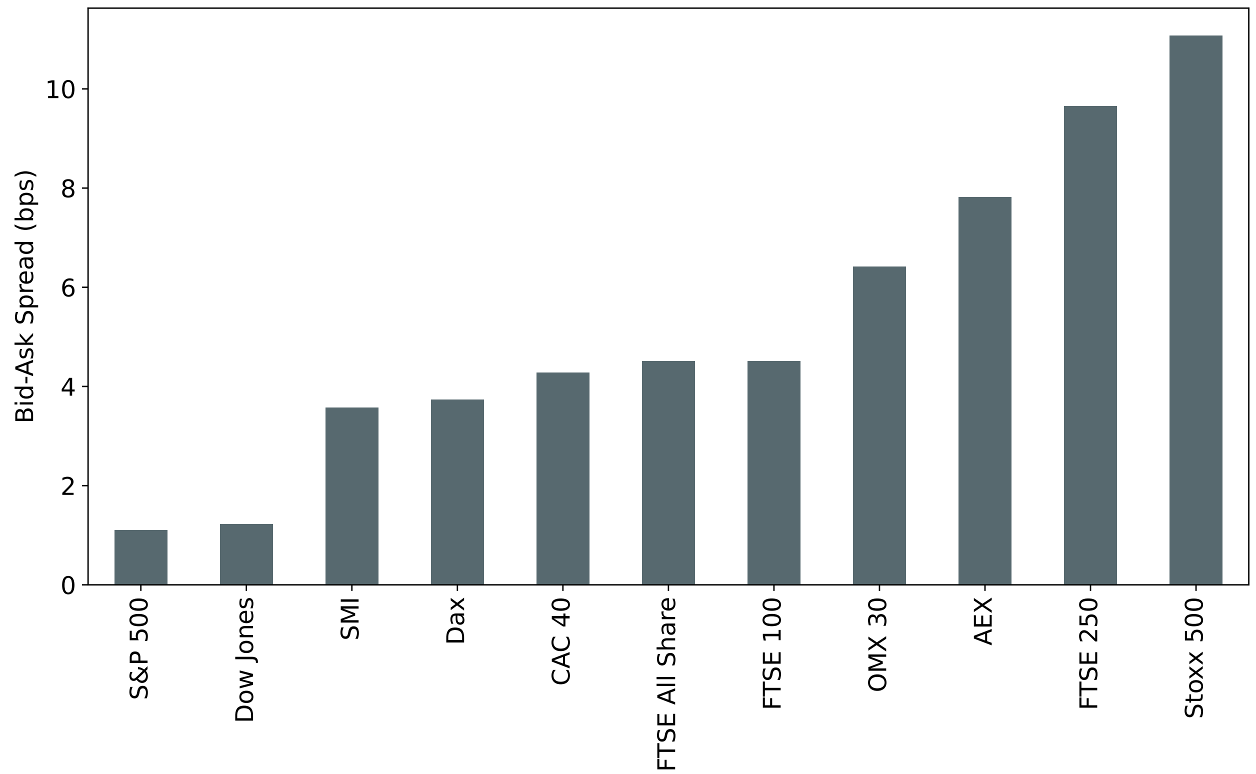


Figure 13: The average Bid-Ask spread computed for the top-20 constituents of major Global and European indices by market capitalisation. The levels shown are the time-average since July-2013.
Source: Refinitiv, Datastream. As of: June-2023

Why Invest in the UK?

9 Significant exposure to global revenue streams

Investing in the UK equity market is not the same as investing in the UK economy. Many large UK-listed companies have exposure to global revenue streams. This international exposure is beneficial for investors as it provides diversification benefits, which can help to mitigate risk and improve portfolio performance. By investing in companies with global revenue streams, investors can gain exposure to a wide range of economic conditions and trends, which can reduce the impact of regional market fluctuations and provide opportunities for growth.

Figure 14 presents the average revenue breakdown for companies across four different capitalisation tranches of the FTSE All-Share Index over the past decade. This shows that, as company capitalisation increases, the fraction of their revenues generated in the UK generally decreases. Companies with the largest market capitalisation generate more than half of their revenues abroad.

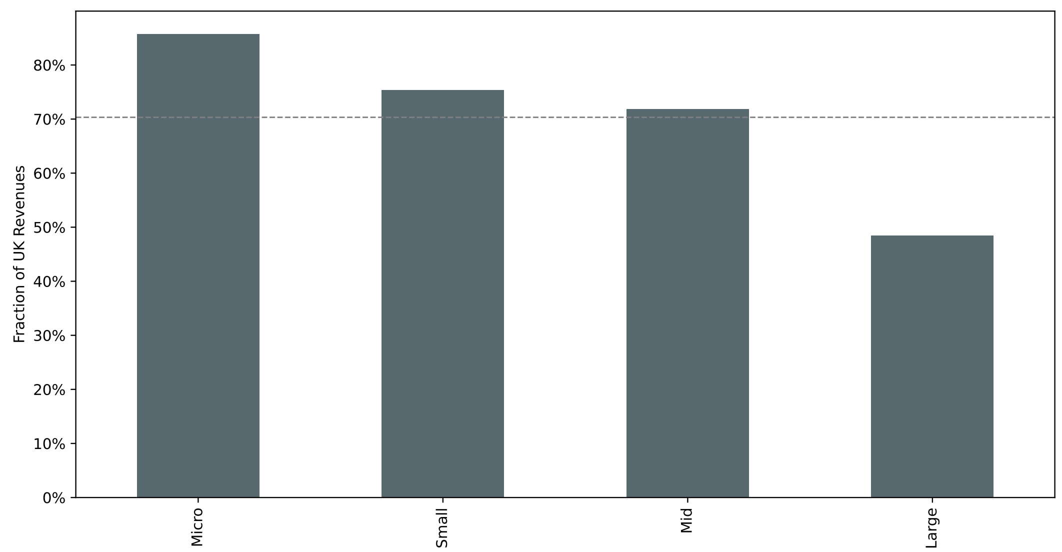
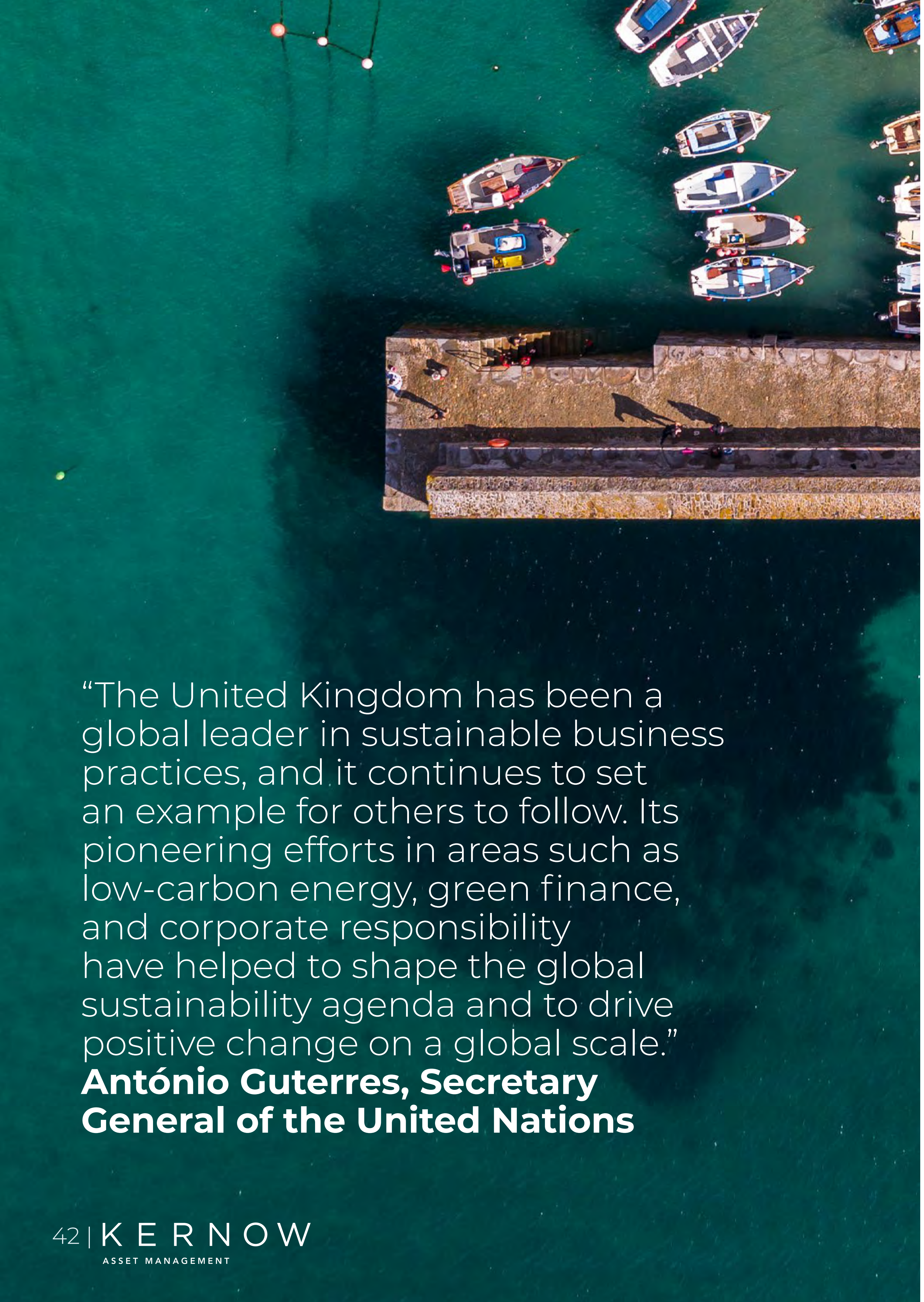


Figure 14: The average fraction of domestic (UK) geographical revenues, for currently active constituents of the FTSE All Share index. Partitioned by capitalisation group. Where we define micro-caps as having market capitalisation under £100m, small-caps having capitalisation under £1bn, mid-caps having capitalisation under £5bn, and large caps having capitalisation over £5bn. **Source:** Refinitiv, LSE. As of: June-2023

Companies with the largest market capitalisation generate more than half of their revenues abroad.



"The United Kingdom has been a global leader in sustainable business practices, and it continues to set an example for others to follow. Its pioneering efforts in areas such as low-carbon energy, green finance, and corporate responsibility have helped to shape the global sustainability agenda and to drive positive change on a global scale."
António Guterres, Secretary General of the United Nations

10 Good governance and sustainability leadership

The UK provides a stable haven for conducting business, with a favourable business outlook, low levels of corruption, and government policies that generally support business activities. The UK came 8th out of 190 countries in the World Bank's 2022 'Ease of doing business' report.

Figure 15 ranks 16 developed European countries by reference to several complementary measures of business friendliness (with surveys conducted in 2022). The heat map depicts the relative ranking of each country on each measure. This shows that the UK ranked in the top third for business friendliness and performed particularly well in relation to economic freedom, international competitiveness, environmental performance, regulatory quality and globalisation.

The UK has a strong regulatory framework that supports Environmental, Social and Governance (ESG) investing. In our view, the data providers in this area are not yet sufficiently mature to draw strong conclusions, other than to say that the UK market takes ESG seriously.

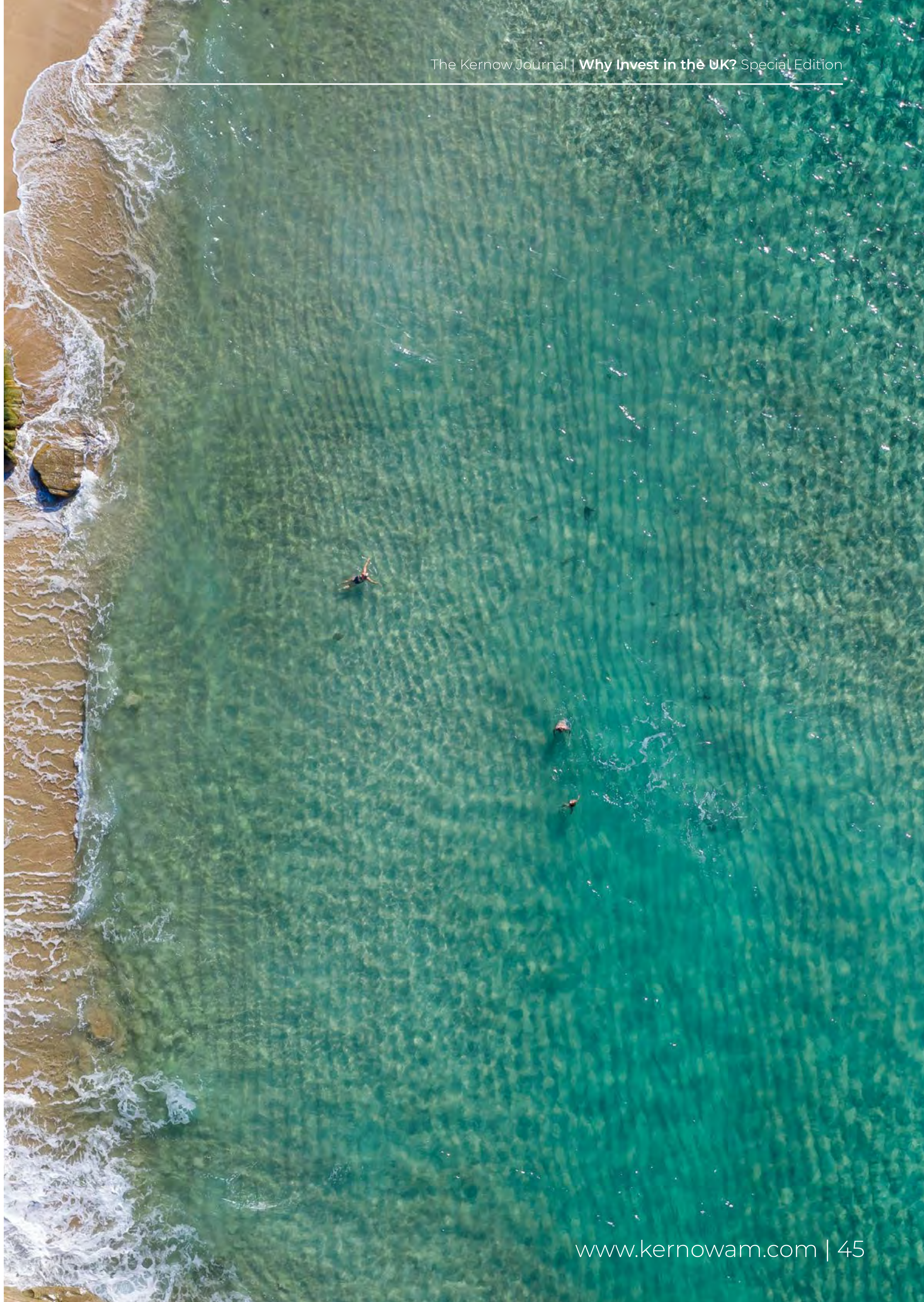
The UK was the first country to introduce a mandatory carbon pricing scheme, which incentivises companies to reduce carbon emissions. It also has disclosure requirements that require companies to report on their ESG performance. This helps investors make informed decisions and encourages companies to improve the transparency of their ESG practices. The UK has an active investment community that is committed to ESG investing. Many UK fund managers have integrated ESG factors into their investment decisions, as Kernow has done.

It is clear that many UK companies are global leaders in corporate sustainability. Several have implemented ambitious ESG strategies and demonstrated a commitment to sustainability across their operations. For example, many UK companies have set ambitious targets for reducing their carbon emissions, improving their social impact, and enhancing their governance practices.

Why Invest in the UK?

	Sweden	Denmark	Switzerland	Finland	Netherlands	United Kingdom	Norway	Germany	Ireland	Luxembourg	Austria	Belgium	France	Spain	Portugal	Italy
International Competitiveness	4	7	1	6	3	5	8	2	13	12	10	9	11	14	15	16
Anti-corruption	3	1	6	2	7	9	4	8	11	5	12	10	13	15	14	16
Economic Freedom	7	2	1	5	9	3	6	8	4	11	10	13	15	12	14	16
Environmental Performance	3	1	2	6	15	4	10	12	11	9	7	16	5	8	14	13
Globalisation	5	6	3	9	1	8	10	12	7	14	4	2	15	13	11	16
Political Stability	3	4	2	10	6	11	9	7	12	1	5	8	15	16	14	13
Regulatory Quality	3	5	6	2	1	7	10	8	9	4	11	12	13	14	15	16
Business Operational Risk	1	10	16	2	9	13	5	8	3	14	15	11	4	7	12	6
Composite	1	2	3	4	5	6	7	8	10	10	11	12	13	14	15	16

Figure 15: The comparison country business friendliness metrics of major European countries. Extracting key metrics relating to the ease of doing business within a particular country, using the most recent Refinitiv business survey output to compare eight metrics (note that the composite is an equally-weighted aggregation of the component metrics) and sixteen European countries. **Source:** Refinitiv Business survey methodology. As of: May-2023



The UK market is liquid, under-researched and has one of the largest dispersion ratings in the developed world.

Conclusion

The UK is a highly compelling investment destination. It is liquid, innovative and of high quality.

The UK is a hub of innovation and champions sustainable business practices. It ranks highly in relation to many metrics which identify the UK as a favourable business environment. The quality of UK-listed companies has remained stable in recent years, even as they have become considerably cheaper in the post-Brexit era. In other words, the UK equity market has become exceptionally under-valued, both relative to other markets and relative to its own long-term history.

With ample capacity and significant variation in company fortunes, the UK has long been a significant component of any globally diverse portfolio. It provides a broad spectrum of opportunity, with a relative abundance of under-analysed companies with significant idiosyncratic components to their return profiles. This suggests that the UK is particularly attractive to investors seeking to take advantage of both the long and short investments and those who focus on a bottom-up, diligent research process. This all bodes well for clients of Kernow.

The landscape for investments in the UK is rich and provides ample opportunity for Kernow's fundamentally-driven long-short investment process.

Visual ELEGANCE

When creating a visualisation, there is often a temptation to convey as much information as possible through a single figure. Nevertheless, in some cases, the clear and simple presentation of information takes precedence over the sheer quantity of data.

The visualisation below is colloquially known as the 'Warming Stripes'. It is an excellent example of a minimalist data visualisation which has been pared back to focus on the overall story told by the data. This chart uses a series of coloured vertical bars, ordered by date, to visually depict temperature trends. A blue-red colour scale represents the average global temperature for that year.

The importance of the Warming Stripes lies in their ability to convey complex climate data in a simple and visually compelling way. This elegant use of colour is highly accessible to all audiences, which. can quickly see the extent and pace of global temperature changes over the past century The Warming Stripes can be used to raise awareness about the urgency of taking action to address climate change. They can also be used as a tool for policymakers, journalists, and educators to communicate the science of climate change to a wider audience in an accessible and engaging way. Irrespective of the discussion around the specifics of climate change, this visualisation fulfils its purpose by conveying a strong message in a universally consumable format.

A balance between visual simplicity and information display enables a better translation between the raw data and the message. Indeed, there is a specific term - 'chart junk' - which refers to unnecessary or distracting elements in a visualisation. The Warming Stripes is a particularly elegant example of strictly removing any superfluous information.

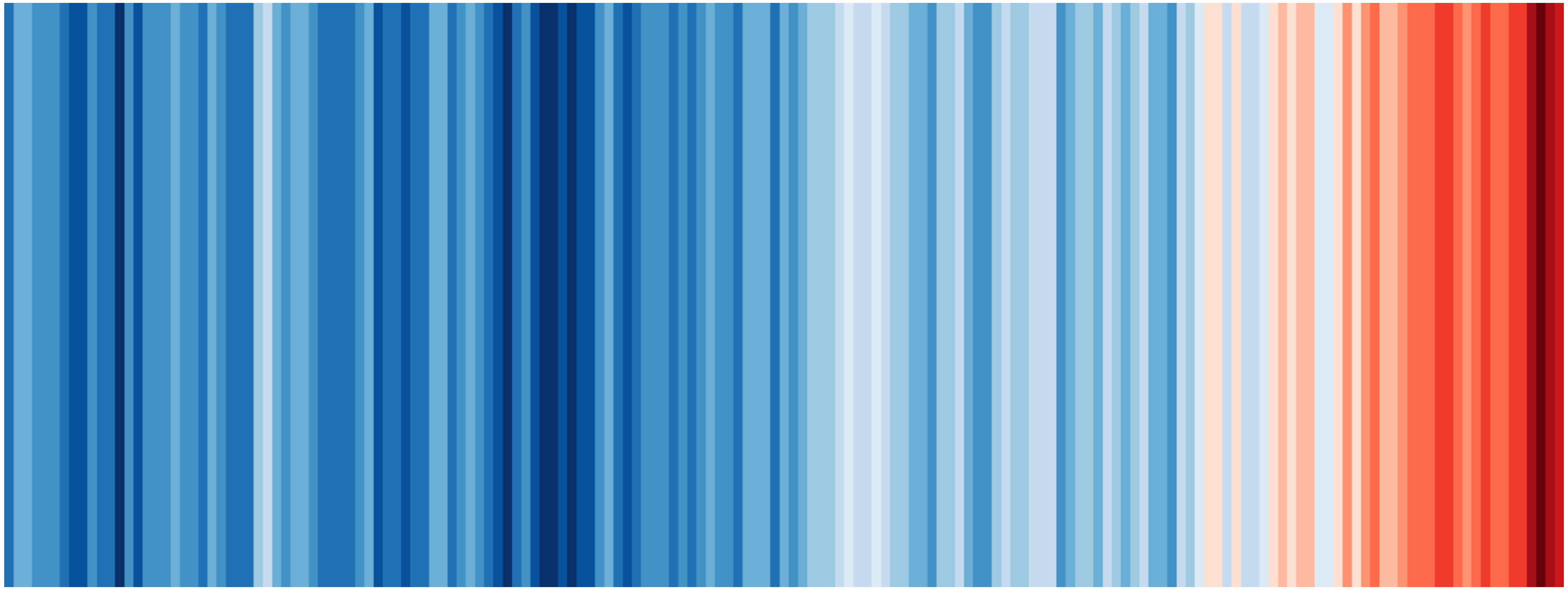


Figure 16: The 'warming stripes' graphic, published by climatologist Ed Hawkins. The progression from blue (cooler) to red (warmer) stripes portrays the long-term increase of average global temperature from 1850 (left side of graphic) to 2018 (right side of graphic). **Source:** https://www.edhawkins.org

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OUR TEAM.

Alyx Wood CHIEF INVESTMENT OFFICER
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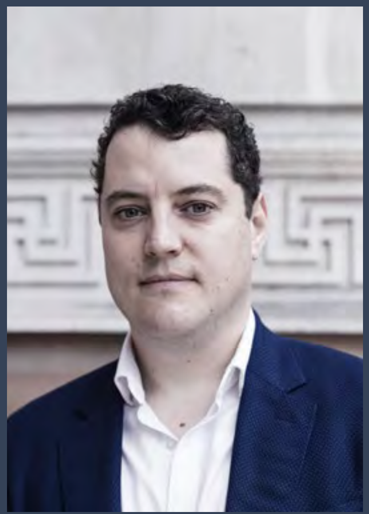
Alyx is responsible for trading and investment research.

He has been investing since the age of fifteen and considers himself fortunate to be able to describe this fascinating activity as his job. Kernow is the realisation of a lifelong dream to work alongside talented people in applying their aggregated investment knowledge in an uncompromised form, putting investors at the forefront of decision making.

Previously Fund Manager at Downing LLP, Vice President at Deutsche Bank AG and Management Consultant at KPMG LLP. Qualified Chartered Accountant (ICAS) and holds the Investment Management Certificate and a BA in Accounting and Economics.



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Edward is responsible for managing the resources of the company and executing Kernow's strategy. He began his career analysing technology and cleantech start-up businesses, before starting his own company in the consulting sector. Covering the alternative energy, food and agriculture sectors as an equity analyst provided him with an excellent insight into the global financial markets. He was attracted to the opportunity of returning to his entrepreneurial roots, backing his own ideas and working with a great team.

Previously Head of Equity Research at boutique investment bank VSA Capital. Holds an MSc in Microsystems & Nanotechnology and a BSc in Mathematics & Artificial Intelligence.

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Having spent over a decade in investment teams spanning both systematic and fundamental investing, Mike has a wealth of experience in quantitative analysis, data science and investment operations. Before joining Kernow, Michael worked within the Advantage team at Lazard Asset Management, focusing on equity research across all major global regions. Prior to this, he was a quantitative analyst at Man AHL, focusing principally on incorporating alternative data within systematic investment processes. Michael began his career in finance at Lloyds Banking Group, independently valuing exotic cross-asset derivatives.

He holds a PhD in Astrophysics from SISSA (Italy) and an MSci in Physics with Astronomy (first class honours) from the University of Nottingham.

CREDITS

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DISCLAIMERS

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